No. 7812.

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In the United States
Circuit Court of Appeals
For the Ninth Circuit.

The Republic Supply Company of California, a corporation,

Complainant,

vs.

Richfield Oil Company of California, a corporation,

Defendant.

Security-First National Bank of Los Angeles, as Trustee, et al.,

Appellants and Cross-Appellees,

vs.

Universal Consolidated Oil Company, a California corporation,

Intervenor, Appellee and Cross-Appellant,

The Chase National Bank of the City of New York, et al.,

Appellees.

ANSWER TO PETITIONS FOR REHEARING.

(Continued on Inside Cover.)

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ANSWER TO PETITIONS FOR REHEARING.

I.

The Petitions for Rehearing Do Not Conform to the Rules of This Court.

(All italics are ours unless otherwise noted.)

Neither petition for rehearing conforms with the rules of the Circuit Court. The petition of the Security Bank fails to have attached thereto a certificate of counsel and for this reason alone it could be disregarded.

So far as the 94-page document filed by the Receiver is concerned, this so-called petition is in direct violation of Rule 29 of this Court. This rule provides, in part, that the petition for rehearing shall "*briefly and distinctly* state its grounds." We cannot help but feel that the Receiver's petition in reality occupies the position of a reply brief, with its attack principally directed towards *amicus curiae,* instead of occupying the name under which it is filed.

It seems quite singular that this Receiver, having full knowledge of the appeals of both Universal and Security Bank; having received copies of the briefs of the various parties prior to the submission of the case for decision; and having failed to file any assignment of errors, any appeal, or any brief, should now present himself to the Court at the *last hour* with this petition. Had counsel for the Receiver seen fit to aid this Court, they could have done so at the appropriate time by filing proper briefs and participating in the case.

The conduct of the Receiver impels one to the belief that it was apparently the Receiver's *original* view that the outcome of the litigation principally affected the lien of the Security Bank and the bondholders under the trust indenture, and that the Security Bank was competent to repre-

sent these secured creditors. Now he seeks to take the side of the Security Bank and aid that party in obtaining a *greater* lien under its trust indenture to the prejudice of Universal under its lien by operation of law.

Furthermore, the Receiver has time and time again misquoted the record of the case; in fact virtually every reference falls into this category.

Notwithstanding the undue length of the petition of the Receiver, and notwithstanding the addition of innumerable citations, it is the belief of Universal that this petition can be answered without emulating the Receiver. It might be noted at this juncture that the Receiver does not present a *single* other Federal case—not heretofore cited by some party to this proceeding in the various briefs—which bears upon the main question of the proper low balance to be used.

II.

The Receiver Is but an Arm of the Court, Having Custody of the Property, and Taking It Subject to All of the Liens and Priorities Theretofore Existing to the Same Extent That Such Liens Could Be Urged Against the Defunct Corporation.

While the Receiver states that he "holds no brief for, and in no wise champions, Richfield or its former officers," yet it is apparent that the Receiver *does* champion the Security Bank in an attempt to aid its lien under its trust indenture.

The Receiver first contends that, as Receiver, his position is different from that of his insolvent, Richfield; and that under the maxim "Equality is the highest equity," Universal's whole claim should *now* be reduced to that of

a general creditor. But the Receiver never raised this question of his so-called preferred status at the trial, nor did the Receiver appeal from the judgment of the Special Master, as approved by the District Court. Consequently this matter must be disregarded at this time.

As stated in *Merriman v. Chicago, etc.* Co. (C. C. A. 7th), 66 Fed. 663:

> "It is, by the well-settled principles of the law, *too late* to present a question for the *first* time on a petition for a rehearing, * * *."(P. 664.)

See also:

> *Bassick Mfg. Co. v. Adams, etc. Corp.* (C. C. A. 2d), 54 Fed. (2d) 285.

Passing this fatal defect for the moment, we submit that both the Receiver, and the Security Bank as trustee for the bondholders, are not in any position to assert defenses *not available to Richfield.* These parties have no greater rights in the premises than Richfield.

Fourth St. Nat'l. Bk. v. Yardley, 165 U. S. 634, 41 L. Ed. 855:

> "The receiver took *no greater* rights in the property of the insolvent bank which came into his possession than that which the insolvent bank possessed. (Citing cases.)" (41 L. Ed. 865.)

In *Fosdick v. Schall,* 99 U. S. 235, 25 Law Ed. 339, the Court said:

> "The possession taken by the receiver is only that of the court, whose officer he is, and adds *nothing* to the previously existing title of the mortgagees. He holds, pending the litigation, for the benefit of whom-

soever in the end it shall be found to concern, and in the meantime the court proceeds to determine the rights of the parties upon the same principles it would if no change of possession had taken place." (25 L. Ed. 342.)

Black v. Manhattan Trust Co. (D. C. Ore.), 213 Fed. 692, states the rule:

> "A receiver by his appointment as such acquires no greater or superior right or interest in the property coming into his hands than the debtor had, and in this relation may be said to stand in the shoes of the debtor; and, furthermore, as a general rule *the receiver takes the property in the same plight and condition, and subject to the same equities and liens,* as he finds it in the hands of the person or corporation out of whose hands it is taken." (P. 693.)

In *U. S., etc. Co. v. Missouri, etc. Co.* (C. C. A. 5th), 269 Fed. 497 (*certiorari* denied 256 U. S. 699), the same rule is announced when the Court stated that:

> "A receiver *does not represent the justiciable rights of the parties* to the litigation of which he is receiver * * *." (P. 501.)

The proposition is so elementary that numerous other cases can be readily cited to the same effect. See also:

Grant v. Phoenix, etc. Co., 106 U. S. 429, 27 Law Ed. 237, 238;

Auten v. City, etc. Co. (C. C. Ark.), 104 Fed. 395, 400;

Geddes v. Reeves, etc. Co. (C. C. A. 8th), 20 Fed. (2d) 48, 53 (*certiorari* denied 275 U. S. 556);

Central, etc. Co. v. Missouri, etc. Co. (D. C. Mo.), 28 Fed. (2d) 176, 177;

Home Trust Co. v. Miller Pet. Co. (D. C. Kans.), 27 Fed. (2d) 748, 750;

Kennizon v. Kanzler (C. C. A. 6th), 4 Fed. (2d) 315, 317;

Vincent National Drug Stores, Inc. (D. C. Pa.), 3 Fed. (2d) 504, 505;

Witherspoon v. Choctaw, etc. Co. (C. C. A. 8th), 56 Fed. (2d) 984, 988;

In Re Greyling Realty Corp. (C. C. A. 2nd), 74 Fed. (2d) 734, 737.

Nor does the fact that Universal has a lien by operation of law change the relation of the Receiver to the property. In *Wright v. Seaboard, etc. Corp.* (C. C. A. 2d), 272 Fed. 807, the Court pointed out that the appointment of the Receiver did not disturb pre-existing liens on the property, and continued:

> "It makes no difference whether the lien has its origin in contract or *arises by operation of law.*" (P. 812.)

For that matter the same rule has been set forth by this Court in the case of *Nicholson v. Western, etc. Co.* (C. C. A. 9th), 60 Fed. (2d) 516, 518.

Neither can the Security Bank, as trustee for bond holders, claim any position higher than that of Richfield. Practically all the property here involved comes under the

trust indenture only by virtue of the after-acquired property clause. The bondholders thus are not bona fide purchasers for value. [Tr. pp. 204, 205.]

> *Fosdick v. Schall,* 99 U. S. 235, 25 L. Ed. 339:
> "They (the mortgagees) are in no sense purchasers of the cars. The mortgage attaches to the cars, if it attaches at all, because they are 'after acquired' property of the company; but as to that class of property it is well settled that the lien attaches subject to all the conditions with which it is encumbered when it comes into the hands of the mortgagor. *The mortgagees take just such an interest in the property as the mortgagor acquired; no more, no less.*" (25 L. Ed. 343.)

The same effect: *Holt v. Henley,* 232 U. S. 637, 58 L. Ed. 767; *Detroit Steel Cooperage Co. v. Sistersville,* 233 U. S. 712, 58 L. Ed. 1166.

None of the authorities presented by the Receiver under this point in anywise detract from the foregoing rules. Thus, in *Clark v. Bacorn* (C. C. A. 9th), 116 Fed. 617, the creditor claimed a judgment lien obtained *subsequent* to receivership. Also, in *Porter v. Boyd* (C. C. A. 3rd), 171 Fed. 305, the creditor claimed a *secret lien* on personal property, which was invalid because it was given to the creditor by the defunct corporation without the change of possession required by law.

In *Harry E. Jones, Inc. v. Kemp* (C. C. A. 9th), 74 Fed. (2d) 623, there is presented a beneficiary of a trust who was unsuccessful in tracing a part of his funds. To aid him in overcoming this defect, an attempt was made to invoke an estoppel against the Receiver. Since such an estoppel could not have been invoked against the association prior to receivership, it is at once evident that the estoppel would be ineffective against the Receiver. While the estoppel was ineffective, it is to be noted that a trust *was* imposed in *Jones v. Kemp* to the extent that the tracing was successful. There is nothing in the case that would indicate any intention by this Court to overrule its conclusion in *Nicholson v. Western, etc. Co., supra.*

The remaining authorities cited by the Receiver, which are treated in other portions of this answer, do not lend any support to his claim that merely because a receivership is involved, a just claim for priority, such as that of Universal's, should be denied.

All of the Receiver's cases fall far short of the claim that he should not be placed in the shoes of Richfield so far as Universal's lien rights are concerned. Certainly the Receiver has no greater rights than Richfield, and he is bound to take Richfield's property subject to the equities existing against Richfield. The *mere* appointment of the Receiver could not divest Universal of its lien. This result follows whether the Receiver represents six thousand creditors or only six creditors.

III.

The Decision Herein Properly Determined That Universal Had Made Out a Prima Facie Case With the Use of the Closing Balances.

A. Under the Facts of This Case the Closing Balances Were the Only Ones That Could be Used.

As the Receiver did not appeal from the award of a prior lien to Universal to the extent of $403,000.00; and the Security Bank in its petition for rehearing seeks same only on the increase of the lien awarded by this Court on the cross-appeal of Universal, it is submitted that the only matter before this Court is the propriety of using the closing balances for the purposes of this increased award.

We have no quarrel with the authorities cited by the Receiver to the effect that the burden of proof is on the *cestui* to trace his funds into property in the hands of the Receiver. But we submit that on proving the existence of the trust, the deposit of Universal funds in the Richfield account in the Security Bank, the daily bank balances and the purchase of property with money from that account, we have amply fulfilled our burden.

It is a well known fact, universally recognized, that the closing balances in a bank account are the *only true balances* of that account, and, contrary to the method used by the Special Master, these closing balances give due and

proper consideration to all items credited or charged against the account.

The bald statement of the Receiver that the closing balances are *not* the only true balances is not sufficient, even were it correct. This whole argument is based upon the false premise that the bank recognizes changes in the account during a day, and, for example, would only certify checks against the *true* balance of the account at the moment that the check is presented. The record clearly discloses that certification would be made if the *ledger account contained "sufficient funds to cover the check."* [Tr. p. 101.] It is only in the case where the account on the ledger does not show sufficient funds that the bank would examine the deposits of the day that have not been posted. In that event, and if there are sufficient deposits the bank would certify the check even though the deposits were not posted. [Tr. p. 101.] But such procedure would not take into account checks received in the clearings and not posted, nor would it necessarily result in a true balance. At no place in the record does it appear that it would be necessary to obtain the true balance for the purpose of certification—rather it is merely that the account should have an *excess* of funds over the amount of the certified check.

The Receiver states that the chief clerk of the bank testified that if a check was presented for *payment or certification,* the teller would look not only to the posted balance but also to the unposted items to ascertain the balance in the account. *This statement is not correct and*

does not appear in the record. From this false premise the Receiver concludes that at any given moment of a day the bank could ascertain the accurate balance of the account. That the bank *could* so do is not disputed if the bank's machinery were brought to a pause while the calculations were being made. That the bank *never* did so do is disclosed by the actual happenings at the bank. [Tr. pp. 100 to 102.] It is all too evident that in the course of an ordinary commercial day the bank would not take time out to render an accurate balance of the account merely for the purpose of determining whether a check should be paid or certified.

The statement of the Receiver that the first transaction each morning must be a debit for the reason that checks came from the clearing house before the bank opened for business is based upon the erroneous assumption that the mere receipt of those items at the bank is sufficient to constitute a charge upon the depositor's account. Receipt of the checks does not constitute an acceptance of them by the bank as the bank may refuse payment of them and return them to the clearing house any time before 2:30 p. m. [Tr. p. 99.] Could anyone contend that a check that was refused payment could have any effect upon the account? Until the time has gone by for returning the checks to the clearing house, or until they are charged against the depositor's account by proper posting, we submit that they may not be properly considered as depletions of that account.

Despite the assertion of counsel, we respectfully submit that we have always contended that the intermediate posted balances on the bank's books during the course of the day are at least better evidence of the status of the account during the day than the method contended for by petitioners. (See Univ. Br. as Cross-App. pp. 24 to 35.) Concededly they do not show accurate balances.

If the evidence could be obtained as to the actual condition of the bank account at any particular moment of a day, then, manifestly, the Security Bank was in the best position to obtain such evidence. That it was impossible to so do, does not and should not militate against the lien of Universal, but, on the contrary, merely gives rise to the conviction that the closing balances are the only definite figures of the bank account. From these figures *must,* of necessity, be taken the low balances. Ample legal support for this conclusion is afforded by the case of *Brennan v. Tillinghast* (C. C. A. 6th), 201 Fed. 609. This case is discussed at length in the brief of Universal as appellee at pp. 15, 16, to which we respectfully refer this Court.

The Supreme Court in one of its late cases, *Jennings v. U. S. F. & G. Co.*, 79 L. Ed. (Adv. Op.) 355, has occasion to refer to the condition of a bank account there involved:

> "There was not even a partial or proportionate payment that could have found its way into the vaults, for the balance *at the close of the operations of the day* was adverse to the collector and in favor of the clearing house." (79 L. Ed. 359.)

B. Without Any Contrary Evidence, the Prima Facie Case of Universal Must Stand.

While the Receiver's brief attacks with vigor many of the authorities cited upon this point, he passes without comment *Central Nat'l. Bank v. Conn. Mut. Life Ins. Co.,* 104 U. S. 54, 26 L. Ed. 693, where it was stated in a headnote by the Court:

> "That, so long as trust property can be traced and followed into other property into which it has been converted, the latter remains subject to the trust, and that if a man mixes trust funds with his own, the whole will be treated as the trust property, except so far as *he may be able to distinguish what is his own*, are established doctrines of equity and apply in every case of a trust relation, and to moneys deposited in a bank account, and the debt thereby created, as well as to every other description of property." (Headnote 3.)

and a decision by the Circuit Court of Appeals of this circuit—*American Surety Co. v. Jackson,* 24 Fed (2d) 768, where it is said:

> "It will thus be seen that the rule itself rests largely on a legal fiction. But if there is a presumption that trust funds have not been wrongfully misapplied or criminally used by the officers of the bank, as held by this court in the Spokane County case, *supra*, and such a presumption no doubt obtains, it would seem to follow as a necessary corollary that *the burden was on the bank* or its successor in interest to prove that the trust funds or some part of them were in fact wrongfully misappropriated or criminally used by the bank. This presumption in nowise conflicts with the

> rule that in the end the claimant must trace the funds and establish his claim thereto by clear and satisfactory proof as against the receiver who represents all creditors." (P. 770.)

In the case of *In re Byrne* (C. C. A. 2nd), 32 Fed. (2d) 189, cited by the Receiver, the Court specifically approved the doctrine that the proof of the trust there involved did make a *prima facie* case.

> "So far as the debit comprised charges not traced to withdrawals by the executors themselves, we think the proof was *prima facie* sufficient. The petitioners put in evidence this account *as it appeared in the bankrupts' books.*" (P. 191.)

Furthermore, if there were any evidence as to the *actual* time of day of the purchase of certain properties, or of the giving of checks for those properties, or of the deposits of funds in the bank account, this evidence was not brought forth by the Receiver. The Receiver was given the opportunity at the hearing before the Special Master to prove, if he could, that instead of funds of Universal *presumably* going into the purchase of this property, it was *actually* the funds of Richfield that so did. The Receiver, however, did not or could not avail himself of this opportunity of proof.

We respectfully submit that this Court correctly stated the law when it held that "proof of the lowest daily closing balances between misappropriations and purchases of the identified properties constituted a *prima facie* showing of the lowest intermediate balances," and that the burden was on the defendant to come forward with evidence in rebuttal, if it could.

IV.

The Decision of the Instant Case Does Not Contravene the Decisions of the Supreme Court or Circuit Courts.

The Receiver maintains that the decision herein is contrary to a number of decisions set forth under his point II c; including two Supreme Court cases and one Circuit Court case.

The two Supreme Court decisions are those of *First National Bank of Princeton v. Littlefield,* 226 U. S. 110, and *Schuyler v. Littlefield,* 232 U. S. 707. Both arose out of the failure of Brown & Co. and involved the efforts of certain *cestuis* to secure a preference. In both cases the effort of the *cestuis* required them to trace funds through the enormous banking transactions of August 24th and 25th, the date of the failure.

In the first case, the defendant showed that against an opening balance of $130,000, there had been drawn on the day in question over $400,000 in checks for other purposes *before* drawing the check for the collateral upon which plaintiff was claiming his lien. [Rec. Pet. p. 48.] The defendant in that way had offered evidence to controvert any case that might have been established. No such evidence was offered by Richfield. Furthermore, there were other trust claimants who were similarly situated and whose equities equalled those of plaintiff. [Rec. Pet. pp. 51, 52.] Of course any preference granted to plaintiff under the circumstances would have been inequitable. It was not the case, as it is here, of a *cestui* owning a lien that is prior to the claims of general creditors.

Also in the *Schuyler v. Littlefield* case, the defendant had offered evidence to controvert that of plaintiff. The evidence showed that the check containing plaintiff's money had been deposited in the bank account prior to the exhaustion of that account on August 25th at 11:00 a. m., by the certification of a check. This effectively eliminated all questions of tracing trust funds even if they were in the account. No similar situation is involved in the instant case. The case of *Schuyler v. Littlefield* is authority for the doctrine that trust funds once dissipated are not thereafter made to reappear by subsequent deposits. Universal entirely agrees with this principle, and in this entire proceeding has adhered strictly to this doctrine. Both of these Supreme Court cases are more fully discussed in the briefs of Universal.

The case of *Connolly v. Lang* (C. C. A. 7th), 68 Fed. (2d) 199, also cited by the Receiver in this connection, involves a depositor in an insolvent bank seeking a preference. It was the decision of the Court that there was *no* trust relation, nor any proof of any augmentation of assets of the bank. The case is therefore not in point.

The Receiver, to bolster his claim under this point, cites the opening balances, checks, and deposits in the Richfield bank account between December 23rd and December 27th. [Rec: Pet. p. 44.] The Receiver does not hesitate to go outside the record for his material, but notwithstanding this, it is only necessary to point out that Universal *is not attempting to trace any of its funds past December 23rd.* [Tr. p. 102.]

A large number of additional cases, not heretofore cited by any party to this proceeding, have been submitted by

the Receiver in his petition. In a number of those cases it was held that no trust existed on the particular facts. These cases are:

Borman v. Sullivan, 77 Fed. (2d) 342;

Connolly v. Lang, 68 Fed. (2d) 199, discussed, *supra;*

First Nat'l., etc. v. City of Miami, 69 Fed. (2d) 346;

Kershaw v. Jenkins, 71 Fed. (2d) 647;

Merchants, etc. v. Austin, 48 Fed. 25;

Swan v. Children's, etc., 67 Fed. (2d) 84.

Manifestly, such cases are of no aid whatsoever since it is stipulated and is a part of the record in this case that a *trust did exist* in favor of Universal.

A number of the Receiver's cases are merely efforts by people who are beneficiaries under constructive trusts to impress the amount due them on the general assets of the defunct bank, or on the estate of the bankrupt, without any *specific* showing on the question of tracing of funds. These cases are:

In Re Brunsing, etc., 169 Fed. 668;

In Re Byrne, 32 Fed. (2d) 189;

Harmer v. Rendleman, 64 Fed. (2d) 422;

Matthews', etc., In Re, 238 Fed. 785;

Mulligan, In Re, 116 Fed. 715;

Multnomah Co. v. Oregon, etc., 61 Fed. 912;

Poole v. Elliott, 75 Fed. (2d) 772;

Wisdom v. Keen, 69 Fed. (2d) 349.

That situation is, of course, entirely different than the instant case, for there has been no attempt herein to spread the lien of Universal *generally* upon the assets of Richfield, and, on the contrary, a very *specific* lien is asked on each parcel of property purchased from moneys in the commingled funds.

Other cases collected by the Receiver in his petition prevent the beneficiary from following his funds in particular accounts because of gaps in the condition of these bank accounts for a period of days, or because of an overdraft in the bank account prior to receivership or bankruptcy. These cases are:

Blumenfeld v. Union, 38 Fed. (2d) 455;

Bogena, In Re, 76 Fed. (2d) 950;

Marshburn v. Williams, 15 Fed. (2d) 589;

Pottorff v. Key, 67 Fed. (2d) 833;

Titlow v. McCormick, 236 Fed. 209.

Again these cases are of no assistance because Universal has at all times admitted that it was not entitled to follow its proceeds beyond the 8th day of January, 1931, when an overdraft occurred in the bank account of Richfield. The condition of the Richfield bank account from day to day of the period in question; the opening balances, the closing balances, and the posted balances that intervened between these two, are all in evidence. There is not a gap of a single day in the proof of the condition

of Richfield's bank account between the taking and deposit of Universal's money and the purchase of properties with moneys from said commingled fund.

If *Nixon State Bank v. First State Bank of Bridgeport* (Ala.), 60 So. 868, is contrary, it would not be controlling on the federal courts. This is true of all other state cases in the same category. It might be observed that in a subsequent case, *Hanover Nat'l. Bank v. Thomas,* 217 Ala. 494, 117 So. 42, the Alabama courts were in full accord with the doctrine of tracing funds through commingled accounts.

None of the foregoing cases are at all comparable to the instant case. Here there was an admitted trust, an admitted purchase of definite parcels of property from the commingled account and no intervening exhaustion of the account at the time of the purchases.

We cannot help but be reminded in this connection of the statement of Chief Justice Marshall in *Cohens v. Virginia*, 6 Wheaton 265, 5 L. Ed. 257:

> "* * * That general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used." (5 L. Ed 290.)

V.

The Doctrine of In re Oatway Properly Applies to This Case.

A large portion of the Receiver's brief is devoted to an attempt to defeat Universal's *whole* claim. In answer to that contention, may we call the Court's attention to the fact that any claim now advanced that Universal has not established its right to any lien upon Richfield properties cannot be raised at this time by the Receiver, who failed to appeal.

As aptly stated by the Supreme Court in a similar situation in the case of *Fitchie, et al. v. Brown, et al.,* 211 U. S. 321, 53 L. Ed. 202:

> "We are of opinion that counsel for the executors had no right to appear and be heard *against* the decree, *no appeal having been taken from it by his clients."* (53 L. Ed. 205.)

See also:

> *Marine Transit Corp. v. Dreyfus,* 284 U. S. 263, 76 L. Ed. 282, 290.

The Special Master found, and the Trial Court held, that Universal was entitled to a lien to the extent of $403,000 without proving that Richfield intended to use Universal funds in the purchase of certain properties, and the Receiver did not appeal from that judgment. If the present argument is now presented to support the petition

of the trustee for the bondholders, we point out that it has now acquiesced in this Honorable Court's affirmance of that judgment and is only requesting a rehearing of that portion of the judgment that increased Universal's lien from $403,000 to $849,000.

As the point was fully considered in our brief as appellee in which, we submit, *all* the present arguments of the Receiver were fully answered, and as all of the Receiver's cases from the Supreme Court and the Circuit Courts have been heretofore cited by the various parties and are discussed at length in our briefs, we will merely refer the Court to the cases that fully support Universal:

In Re Oatway (1903), 2 Ch. Div. 356;

Brennan v. Tillinghast, 201 Fed. 609;

In Re Pacat, 27 F. (2d) 810;

Fiman v. So. Dak., 29 F. (2d) 776;

Primeau v. Granfield, 184 Fed. 480;

and to our brief as appellee in which we discuss at length the application of these cases. (See Univ. Br. pp. 12, *et seq.*)

VI.

The Decisions of the California State Courts Are Not Binding Upon the Federal Courts Insofar as They Affect the Tracing of Trust Funds. Were the California Cases Binding, We Still Submit That They Are Favorable to Universal's Position and Not to the Receiver's.

When this matter was being tried before the Special Master, briefs were filed by all of the parties thereto, including the Receiver. The Receiver *then* took the view that the federal rules were controlling on the question of tracing of funds, citing in support thereof the cases of *John Deere Plow Co. v. McDavid* (C. C. A. 8th), 137 Fed. 802, and *Beard v. Independent District* (C. C. A. 8th), 88 Fed. 375. We quote from that brief:

> "The matter of tracing funds is a matter of equity jurisprudence upon which the Federal Courts *are bound* by the decisions of the United States Supreme Court and they do not follow State Court decisions unless the latter are based on interpretations of state statutes or are in accord with the weight of authority generally." (P. 44.)

The Security Bank, in the brief before this Court likewise stated that the federal equity doctrine as to the tracing of trust funds was controlling, and cited the same federal cases. (Br. Sec. Bk., p. 25.)

Universal (in its brief as appellee, on page 20 thereof) conceded that the rules promulgated by the federal courts on the tracing of funds were controlling, but submitted that the decisions of the state courts were at least entitled to consideration. Thereupon a number of state decisions

were cited by Universal, including *Mitchell v. Dunn,* 211 Cal. 129.

This entire proceeding has been tried before the Special Master, the District Court, and upon the date of the filing of the petition of the Receiver, before the Circuit Court on the theory advanced by and agreed to by all parties that the federal rules were controlling.

Now, for the *first* time, the Receiver desires to take the opposite tack and claim that the rules of the state courts are the ones to be followed, and not those of the federal courts. A new issue not heretofore presented in any of the briefs is now being tendered to this Court, and under the familiar rule pertaining to rehearings, this new issue might properly be disregarded. *Merriman v. Chicago, etc. Co., supra.*

In his petition, the Receiver now seeks to distinguish the federal cases hereinbefore cited on the grounds that when the state court decisions attempt to create preferences and priorities without any tracing the state rule is inapplicable because it is then a matter of preference rather than property. If we understand counsel, we feel constrained to remark that this is a distinction without a difference. In each one of the federal cases the sole purpose involved was a tracing of trust funds, and the decision in *John Deere Plow Co. v. McDavid, supra,* squarely and unequivocally decides that the tracing of trust funds concerns,

> "* * * a rule of preference in equity, and upon that question the Federal decisions *must* control in this court, * * *."

Likewise in *Beard v. Independent District, supra*, the matter covered was the tracing of trust funds. Such right to follow trust funds was not created by statute but was based upon general principles of equity, and the rulings of the Iowa Supreme Court there involved could not be conclusive. The decisions of the Iowa Supreme Court could not rightfully be said to "constitute a rule of property which other courts are bound to follow."

It is quite appropriate to call attention to two of the cases in the Receiver's petition. In *Wisdon v. Keen,* 69 Fed (2d) 349, the Court says:

> "Whether the question be one of general equity jurisprudence or of the application of the federal law relating to insolvent national banks, *the views of the federal courts must in such courts be controlling.*" (p. 350.)

Elmer v. Kemp (C. C. A. 9th), 67 Fed. (2d) 948, decided by this Court, should have put at rest these new ideas of the Receiver. There was an attempt to impress a trust on all the real and personal property of the Elmer Oil Company. Needless to say, the property was located in California. In support of the claim, the claimants cited *Byrne v. McGrath,* 130 Cal. 316, which case was in their favor on the relevant facts. This Court *absolutely* refused to follow the state decision, saying:

> "Moreover, in a federal court of equity, we must decide cases in accordance with our view of the general principles of equity jurisprudence. Kuhn v.

> Fairmont Coal Co., 215 U. S. 349, 363, 30 S. Ct. 140, 54 L. Ed. 228; Russell v. Southard, 12 How. 139, 13 L. Ed. 927; Neves v. Scott, 13 How. 268, 14 L. Ed. 140. The decisions of the particular state in which the cause of action arose are to be followed *only in so far as they conform to established principles of equitable jurisprudence.*" (P. 952.)

However, were this matter to be determined under the rules of the Court of California, we submit that the decision in *Mitchell v. Dunn, supra,* would be favorable to Universal.

> "The law will not permit the trustee to say that the only permanent investment made with moneys from the fund was with personal funds, and that the dissipated funds belonged to the *cestui.*" (211 Cal. 136, 137.)

We submit that small comfort can be drawn by the Receiver from the case of *Mitchell v. Dunn, supra.* We must commend the Security Bank for its frankness in its brief, for in discussing this California case, it says: "As a matter of fact, Mitchell v. Dunn does not purport to follow the Oatway rule, although it will be conceded that *in effect it attains the same result.*" (Br. Sec. Bk., p. 64.)

In order that this answer should not be made unduly long, we make no reference to the various state cases from other states than California, as the doctrine must be controlled by the decisions of the federal courts.

Conclusion.

As a matter of fact, the Receiver and general unsecured creditors have very little to gain or lose by the present litigation, and this, regardless of how the litigation may terminate. The statement is made by the Receiver that this is not like a case between two individuals, whereas, as a matter of fact, the present issue very nearly *approximates* that situation. We have Universal on one hand claiming a lien by operation of law on certain specific assets (purchased with Universal's own money, unlawfully taken from it), and on the other hand the Security Bank claiming a lien on the great bulk of the same assets (which were not purchased with moneys belonging to its bondholders) under its trust indenture. Each party's lien, to the extent declared, of necessity *precedes* general unsecured creditors.

The prior lien that has been awarded Universal by this Court's opinion, approximately $849,000.00, cuts down Universal's general unsecured claim to approximately $333,000.00. To the amount that Security Bank has failed to impress its lien upon this same property under its trust indenture, it has been relegated to the category of a general unsecured creditor. In other words, the greater award under Universal's lien cuts down Universal's unsecured claim, but it also increases the unsecured claim of the Security Bank to an identical amount. Hence neither the Receiver or the other unsecured creditors are affected adversely by the decision.

The decision herein is within the proper scope of equity jurisprudence. As stated by the Supreme Court in *Adams v. Champion,* 79 L. Ed. (Adv. Op.) 366:

> "Equity fashions a trust with *flexible* adaptation to the call of the occasion." (79 L. Ed. 369.)

It is respectfully submitted that the petitions, and each of them, should be denied.

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